

In our South Carolina filing, we explained that a procompetitive pricing methodology is a necessary precondition to a fully and irreversibly opened local market.<sup>39</sup> Our evaluation of a state's wholesale pricing structure does not require any particular methodology, but rather, insists on a reasoned application of a pro-competitive one. We expect that in most cases, a BOC will be able to demonstrate this by relying on a reasoned pricing decision by a state commission. However, if a state commission has not explained its critical decisions, or has explained them in terms that are inconsistent with procompetitive pricing principles, the Department will require further evidence that prices are consistent with its open-market standard.

In Louisiana, BellSouth's pricing for unbundled elements is in most respects consistent with the Department's focus on pro-competitive pricing principles. Significantly, BellSouth's permanent prices for interconnection, unbundled elements and transport and termination, recently approved by the LPSC, were developed from a study by the LPSC's staff consultant according to the TSLRIC/LRIC ratemaking requirements that the LPSC adopted after the Telecommunications Act was passed, as well as the TSLRIC principles of the Michigan PSC.<sup>40</sup> The Department is

---

<sup>39</sup> DOJ South Carolina Evaluation at 35-40.

<sup>40</sup> Louisiana Public Service Commission, In re: Regulations for Competition in the Local Telecommunications Market, Amendments as Adopted 3/19/97 to Sections 901, 1001, and 1101 of the Regulations for Competition in the Local Telecommunications Market General Order Dated March 15, 1996 (as amended 10/16/96), at § 901.C & n.1, § 1001.E (Mar. 19, 1997), attached to BellSouth Louisiana Brief as App. C, Tab 186, App. "A." The Department understands the language in the LPSC's rules to the effect that "[t]here is no mandate that unbundled elements be provided by the ILEC to TSPs at its TSLRIC or LRIC of providing such elements," *id.* § 1001.E, to permit negotiation of rates on other bases, not as authorization for the LPSC itself to depart from the forward-looking pricing principles that it directed ILECs to use in providing cost studies to the LPSC, which would be used in conducting arbitrations or reviewing

satisfied that this methodology embodies the basic concepts of forward-looking cost-based pricing, and is consistent with the Department's competitive standard.

Despite the pro-competitive methodology adopted by the LPSC, the lack of any plan for a geographic deaveraging of local loop prices over time or any adequate showing of cost-based prices for collocation preclude us from determining that the pricing structure in Louisiana will facilitate efficient and effective competitive entry. In another area -- the pricing of vertical features associated with unbundled switching -- we are not satisfied on the current record that BellSouth's pricing is consistent with our open-market standard, but we do not preclude the possibility that BellSouth might be able to justify its pricing under that standard with additional evidence.

Geographic Deaveraging. As we noted in our South Carolina filing, we would expect the cost of unbundled network elements -- particularly, local loops -- to vary across different geographic areas within the state, and thus, would expect states to adopt some mechanism for geographically deaveraging prices, now or in the future.<sup>41</sup> The LPSC, however, has not offered any justification for refusing to adopt geographically deaveraged prices. Various potential local competitors advocated geographic deaveraging of unbundled elements,<sup>42</sup> while both BellSouth

---

SGATs to establish rates under section 252 of the 1996 Act.

<sup>41</sup> DOJ South Carolina Evaluation, at 41 n.54.

<sup>42</sup> See, e.g., Louisiana Public Service Commission, Docket Nos. U-22022/U-22093, Post Hearing Brief of MCI Telecommunications Corp. at 10 (Sept. 29, 1997), attached to BellSouth Louisiana Brief as App. C-3, Vol. 34, Tab 276; Louisiana Public Service Commission, Docket Nos. U-22022/U-22093, AT&T Communications of the South Central States, Inc.'s Post-Hearing

and the LPSC's staff consultant proposed averaged statewide rates.<sup>43</sup> Because the LPSC's ALJ concluded that geographic deaveraging was necessary for an accurate cost determination, she recommended that the LPSC reject the use of statewide averaged rates and adopt instead geographic deaveraging based on broad "density" zones, proposing that the LPSC reserve a final decision on an appropriate method of geographic deaveraging while continuing to use statewide averaged rates on an interim basis.<sup>44</sup> The LPSC failed to adopt any phased-in program of geographic deaveraging -- without any analysis or explanation -- in favor of a permanent statewide averaged UNE rate structure.<sup>45</sup>

The lack of any plan for geographic deaveraging, particularly in loop prices, will have a significant effect on local entry in Louisiana using unbundled elements, and could affect the

---

Brief, at 4-5 & n.5 (Sept. 29, 1997), attached to BellSouth Louisiana Brief as App. C-3, Vol. 34, Tab 281.

<sup>43</sup> See Louisiana Public Service Commission, Docket Nos. U-22022/U-22093, Hearing Transcript at 3091 (Sept. 24, 1997) ("Dismukes Testimony"), attached to BellSouth Louisiana Brief as App. C-3, Vol. 34, Tab 273 (no analysis by staff consultant of rate deaveraging); Complete Transcript of October 22, 1997 Open Session of the Louisiana Public Service Commission at 85-86 ("Tr. of LPSC Oct. 22, 1997 Open Session"), attached to BellSouth Louisiana Brief as App. D, Tab 2 (LPSC staff opposed to any geographic deaveraging of wholesale rates before geographic deaveraging of retail rates and a universal service fund proceeding).

<sup>44</sup> Louisiana Public Service Commission, Docket Nos. U-22093/U-22022, Final Recommendation, at 26, 58 (Oct. 17, 1997) ("Louisiana ALJ Pricing Recommendation"), attached to BellSouth Louisiana Brief as App. C-3, Vol. 34, Tab 284.

<sup>45</sup> Louisiana Public Service Commission, Docket Nos. U-22093/U-22022, Order No. U-22022/22093-A, at 4-5 (Oct. 24, 1997) ("Louisiana Final Pricing Order"), attached to BellSouth Louisiana Brief as App. C-3, Vol. 34, Tab 285.

viability of such competition for some types of customers. Experience from all other states that have established deaveraged prices, as well as from general nationwide studies, indicates that there are considerable variations in loop costs between urban and rural areas, and there is certainly no evidence in this record that would suggest otherwise for Louisiana.<sup>46</sup> BellSouth has not argued that there are no differences in loop costs across geographic areas, but has defended the lack of deaveraging on the ground that deaveraging would increase the incentives of competitors to focus their offerings on more densely populated areas.<sup>47</sup>

As the 1996 Act makes quite clear, there must be a transition to an efficient, sustainable, and equitable competitive environment, whereby unbundled element prices will eventually be geographically deaveraged to reflect differences in costs, and subsidies to support universal service will be provided explicitly and in a competitively-neutral manner. To be sure, this transition will require the reform of universal service support, as called for by section 254(f) of the 1996 Act, to replace the implicit subsidization in present retail rates for local service and to permit appropriate adjustments to a state's rate structure.<sup>48</sup> Thus, while we do not believe that

---

<sup>46</sup> According to MCI, the deaveraged loop rate for the most densely populated areas in Louisiana would decrease from \$19.35 to \$10.12. Comments of MCI Telecommunications Corporation, CC Docket No. 97-231, at 56 (Nov. 25, 1997).

<sup>47</sup> Louisiana Public Service Commission, Docket Nos. U-22022/U-22093, Post Hearing Brief of BellSouth Telecommunications, Inc., at 51-52 (Sept. 29, 1997), attached to BellSouth Louisiana Brief as App.C-3, Vol. 34, Tab 274.

<sup>48</sup> In discussing a transitional approach for geographic de-averaging, we do not suggest that states need or should wait to establish deaveraged rates for unbundled elements. Indeed, many have done so already.

geographic deaveraging must necessarily take place immediately, before section 271 authority can be granted, it must at least be clear that it will be accomplished over some transition period. However, when there has been no measure of geographic deaveraging of loop prices, and there is no reasonable transition plan to implement such deaveraging in the future, we cannot conclude that a market is or will be open to efficient competition using unbundled elements.

Collocation. BellSouth offers no prices at all in Louisiana for one of the significant components of physical collocation -- space preparation -- leaving the determination of such prices to negotiation on a case-by-case basis. For other components, such as space construction, BellSouth also intends to impose charges that have not been adequately demonstrated to be cost-based.<sup>49</sup> Because physical collocation is an important component of providing interconnection and access to unbundled network elements under section 251(c)(6), the absence of reasonable and predictable prices for collocation threatens to act as a formidable barrier to entry.

The LPSC's ALJ concluded that BellSouth's rates for collocation should be subject to the same forward-looking cost standards applicable to pricing of interconnection and unbundled network elements generally, and proposed to use a collocation cost model offered by potential competitors.<sup>50</sup> The LPSC's staff consultant did not reject this model, but simply stated that she did not have time to analyze it, and therefore used BellSouth's cost assumptions with limited

---

<sup>49</sup> Louisiana Final Pricing Order Attach. A at 6.

<sup>50</sup> Louisiana ALJ Pricing Recommendation at 52-55, 64-65.

modifications of the final prices for other across-the-board corrections.<sup>51</sup> The LPSC, however, did not discuss collocation at all in its final pricing decision, but simply rejected the ALJ's recommendations and allowed BellSouth's handling of physical collocation space preparation on an individual case basis, as well as its proposed construction and other charges, to stand.<sup>52</sup>

Although we understand that there may be instances in which it would be justifiable to postpone addressing certain issues, as a rule we believe that it is far preferable for a BOC to have prices and other relevant terms of service in place when it applies, rather than to defer the establishment of such terms for future negotiations following its interLATA entry, when its incentives to delay local competitive entry would be heightened. On the current record, BellSouth has not shown that it could not provide greater specificity in advance as to how it will charge for physical collocation space. Because its failure to commit itself to certain pricing principles raises significant competitive concerns -- i.e., raising the possibility of unreasonable prices and drawn out negotiations that have the effect of precluding competitive entry -- we cannot conclude that the pricing structure for collocation will permit efficient entry so as to fully and irreversibly open the local market.<sup>53</sup>

Vertical Switching Features. The issue of pricing for vertical switching features received considerable attention from both the consultant and the ALJ. However, BellSouth's study on this

---

<sup>51</sup> Dismukes Testimony at 3119-3120.

<sup>52</sup> Louisiana Final Pricing Order Attach. A at 6.

<sup>53</sup> See, e.g., DOJ Oklahoma Evaluation at 31-34.

issue was submitted at a late stage in the state pricing docket, as BellSouth had initially resisted providing vertical features as unbundled elements. The consultant rejected some of BellSouth's cost assumptions, but still priced vertical switching features as a separate element in addition to the switch port charge of \$2.20, recommending a charge of \$8.28 for all vertical features that was approved by the LPSC.<sup>54</sup> Our concern with the pricing of vertical services does not go merely to whether a charge for vertical features should be imposed separately or bundled with the switch port charge, but also to the costs associated with purchasing them. The ALJ proposed not to adopt any permanent rate for vertical switching features, but to conduct further proceedings on this issue, in light of the limited opportunity the consultant had to analyze BellSouth's cost data, while using the consultant's recommended rate on an interim basis.<sup>55</sup> The LPSC rejected this recommendation without explanation, adopting the recommended rate as permanent without conducting further proceedings.<sup>56</sup> In light of the ALJ's and the LPSC consultant's suggestions that this issue would have benefited from a greater opportunity for analysis and discovery, possibly leading to a significantly different recommendation, we question whether the LPSC's procompetitive pricing principles were applied in a reasoned fashion as to vertical services.<sup>57</sup>

---

<sup>54</sup> LPSC Final Pricing Order at 4; Dismukes Testimony at 2867-69, 2885-87, 2913-17, 3054-74, 3111-17.

<sup>55</sup> Louisiana ALJ Pricing Recommendation at 52, 64.

<sup>56</sup> Louisiana Final Pricing Order at 4-5.

<sup>57</sup> See Tr. of LPSC Oct. 22, 1997 Open Session at 93-94 (comments of staff consultant Kimberly Dismukes). A number of other states, including ones in the BellSouth region, have rejected the concept of imposing a separate charge for vertical switching features and agreed that

## 2. Pricing of Resold Services at Wholesale

The 1996 Act requires that all retail services be made available for resale at a wholesale discount. 47 U.S.C. § 251(c)(4). Specifically, it provides that states must set the wholesale discount based on an "avoided" cost methodology, using "retail rates charged to subscribers" and "excluding the portion thereof attributable to any marketing, billing, collection and other costs that will be avoided by the local exchange carrier." 47 U.S.C. §252(d)(3). In assessing whether a procompetitive pricing structure is in place in a particular state, the Department will assess not only the pricing of UNEs, but also whether competitors have access to resold services at a procompetitive, i.e., "avoided cost" discount, and under reasonable terms and conditions.

In setting BellSouth's general resale discount in Louisiana at 20.72%, the state commission has commendably explained its methodology and application of the "avoided cost" concept, identified relevant issues posed by the determination of avoided costs, and shown how it

---

the costs of most or all of these features are properly reflected as part of port charges in the range of \$2-3, a quarter of BellSouth's total price for a switch port and its vertical features in Louisiana. See, e.g., Georgia Public Service Commission, Transcript of Administrative Session, at 7, 11, 16, 19 (Oct. 21, 1997) (permanent rate of \$1.85 for switch port including vertical features); Florida Public Service Commission, In re: Petitions by AT&T, et al., for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996, Docket No. 960833-TP, Order No. PSC-96-1579-FOF-TP, Final Order on Arbitration at 15-16 and Attach. A (Dec. 31, 1996) (cost-based rate of \$2.00 for switch port including vertical features); New York Public Service Commission, Case No. 95-C-0657, 94-C-0095, 91 C-1174, Opinion No. 97-2, Opinion and Order Setting Rates for First Group of Network Elements, at Attach. D, Element Rates (Apr. 1, 1997) (including most listed vertical features in port charge of \$2.50).



applied its methodology based on BellSouth's cost data to arrive at the discount.<sup>58</sup> In so doing, the LPSC relied on a detailed independent analysis by its own staff consultant that distinguished wholesale from retail functions, reflecting the "opportunity to avoid" cost methodology rather than whether BellSouth chose to continue to incur retail costs.<sup>59</sup> The Department is satisfied that the process that the LPSC has followed to set this general discount, and the result it has reached, are consistent with the Department's competitive standard.<sup>60</sup>

---

<sup>58</sup> Louisiana Public Service Commission, In re: Review and Consideration of BellSouth Telecommunication, Inc.'s Resale Cost Study, Docket No. U-22020, Order, at 9-16 (Nov. 12, 1996), attached to BellSouth Louisiana Brief as App. C-4, Vol. 38, Tab 329.

<sup>59</sup> The LPSC's approach to resale pricing, while not denominated as an "avoidable" cost methodology, appears to operate consistently with the Commission's underlying concern that "resellers should not be required to compensate a BOC for the cost of services, such as marketing, that resellers perform." Michigan Order ¶ 295.

<sup>60</sup> We do point out, however, that there is one area in which BellSouth's resale policies raise questions, restrictions on resale involving Contract Service Arrangements (CSAs), see Louisiana Public Service Commission, Regulations for Competition in the Local Telecommunications Market, § 1101.B.2 (as amended Mar. 19, 1997), attached to BellSouth Louisiana Brief as App. C-2, Vol. 22, Tab 186. The Commission has recently stated that restrictions analogous to those in Louisiana violate the Act and the Commission's binding regulations on the scope of resale. AT&T Communications of the South Central States, Inc. v. BellSouth Telecommunications, Inc.; the Mississippi Public Service Commission; and the Public Service Commissioners of the State of Mississippi, C.A. No. 3:97CV400WS (S.D. Miss.), Memorandum of the Federal Communications Commission as Amicus Curiae at 13-24 (filed Dec. 4, 1997). In its Local Competition Order, ¶ 948, the Commission specifically rejected any exemption from the resale obligation for "contract and other customer-specific pricing arrangements."

**B. BellSouth Has Failed to Institute Performance Measurements Needed to Ensure Consistent Wholesale Performance**

A conclusion that a market has been “fully and irreversibly opened to competition” requires both a demonstration that the competitive conditions currently in place will foster efficient competition, as well as assurances that those conditions will remain in place after a section 271 application has been granted. In terms of wholesale performance—where a BOC’s systems will be critical to enabling its competitors to succeed in the marketplace—an appropriate means of “benchmarking” performance is needed. As we have explained previously, we examine whether a BOC has established (1) performance measures and reporting requirements so that wholesale performance can be measured; (2) performance standards – *i.e.*, commitments made by the BOC to meet specified levels of performance (preferably backed up by liquidated damages clauses); and (3) performance benchmarks – *i.e.*, a track record of performance. These steps will permit an assessment of current performance and will enable competitors and regulators to more effectively address any post-entry “backsliding” from prior performance through contractual, regulatory, or antitrust remedies.

As described in our South Carolina Evaluation, at 45-48, BellSouth has failed to “provide[] sufficient performance measures in its evaluation to make a determination of parity or adequacy in the provision of resale or UNE products and services to CLECs.” *Friduss South Carolina Aff.* ¶ 78. BellSouth responds that several measurements the Department listed were

“included in the South Carolina filing, yet overlooked.”<sup>61</sup> The Department did not overlook that data. The Department’s Evaluation and the Friduss Affidavit make clear that they were focusing on BellSouth’s permanent performance measures,<sup>62</sup> and the Department found—and confirmed in discussions with BellSouth—that BellSouth had not included these measurements as part of its permanent measurements. As the Department has repeatedly stated, one important purpose of performance measurements is to detect backsliding and thus facilitate meaningful post-entry oversight that ensures that the market opening is irreversible. Data such as BellSouth provided are important for evaluating BellSouth’s support processes and determining whether they operate in a nondiscriminatory manner at the present time, but that present data cannot detect backsliding in the future. Future data is, of course, required for that purpose, and this necessitates an *ongoing* commitment to provide these performance measures.

In its current application, BellSouth has added some permanent performance measures, but major deficiencies remain.<sup>63</sup> Given BellSouth’s lack of performance measures in a number of

---

<sup>61</sup> Reply Affidavit of William N. Stacy ¶ 2, attached to Reply Brief in Support of Application by BellSouth for Provision of In-Region, InterLATA Services in South Carolina, In re: Application of BellSouth Corporation, BellSouth Telecommunications, Inc., BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina, CC Docket 97-208 (Nov. 14, 1997) (“South Carolina Reply Brief”) as App. Tab 8.

<sup>62</sup> The Department understands that BellSouth is committing to report only its permanent measurements on a regular, ongoing basis to CLECs and regulatory authorities.

<sup>63</sup> For example, BellSouth’s list of permanent performance measurements still lacks complete, properly defined measurements for (1) Pre-order System Response Times—Five key functions, (2) Total Service Order Cycle Time, (3) Service Order Quality, (4) Speed of Answer—Ordering Center, (5) Average Service Provisioning Interval, (6) Percent Service Provisioned Out of Interval, (7) Port Availability, (8) Completed Order Accuracy, (9) Orders

crucial areas, we still are unable to determine whether BellSouth has established enforceable performance standards for these areas or a track record, or benchmark, of wholesale performance.

As is true with our analysis of wholesale support generally, our insistence on performance benchmarks does not require any particular level of use in Louisiana. Appropriate benchmarks may be established through commercial performance elsewhere in the BellSouth region. In the event that a BOC is not able to set a benchmark through actual use – though we doubt that any region will not have some actual competitive entry – the Department would consider other means of ensuring adequate performance, including enforceable performance standards and other means of demonstrating wholesale capability, *i.e.*, carrier-to-carrier testing, independent auditing, or internal testing. In this case, however, BellSouth has not yet instituted the necessary performance measures, adopted enforceable performance standards, or demonstrated a satisfactory performance benchmark (through actual use or otherwise). Thus, given our inability to conclude that the necessary protections against backsliding are in place, we cannot conclude that the market has been fully and irreversibly opened to competition.

**C. BellSouth's "Public Interest" Arguments Do Not Justify Approval of This Application**

BellSouth erroneously contends, as it did in South Carolina, that the benefits of allowing its entry now into the interLATA market in Louisiana warrant approval of this application under

---

Held for Facilities, (10) Billing Accuracy, (11) Billing Completeness, (12) Operator Services Speed of Answer, (13) Directory Assistance Speed of Answer, and (14) 911 Database Update Timeliness and Accuracy. These measures, and their significance, are discussed in the Friduss South Carolina Affidavit.

the "public interest" standard. BellSouth and its economic experts significantly overvalue the benefits of the BOC's long distance entry now, and virtually ignore the benefits to be gained from opening BellSouth's local markets, as explained in the Supplemental Affidavit of Marius Schwartz.<sup>64</sup> Primarily, BellSouth and its experts reiterate here the mistaken or unsupported claims they made in South Carolina and that Prof. Schwartz has already refuted. To the extent they have offered any additional arguments in response to Prof. Schwartz, they have failed to present any credible evidence that would affect the validity of his conclusions. Indeed, only one of BellSouth's economic experts, Prof. Hausman, has even attempted to respond to Prof. Schwartz's Supplemental Affidavit in any detail.<sup>65</sup> His criticisms, which are addressed in detail in Appendix A to this Evaluation, are mistaken on a variety of grounds or simply unclear, and for all of the reasons discussed in Appendix A, the Commission should reject Prof. Hausman's arguments. In short, the Department adheres to its position that the "fully and irreversibly opened to competition" standard, as explained by Prof. Schwartz, continues to represent the best reconciliation of the competing benefits and risks associated with local and long distance markets in the section 271 entry process.

---

<sup>64</sup> This affidavit is attached to this Evaluation as Ex. 2 ("Schwartz Supp. Aff.").

<sup>65</sup> Reply Declaration of Prof. Jerry A. Hausman, attached to BellSouth South Carolina Reply Brief, CC Docket 97-208, as App. Tab 2.

As explained in our South Carolina filing<sup>66</sup> and in the Schwartz Supplemental Affidavit, the Department's analysis and that of Prof. Schwartz, in contrast to that of Prof. Hausman and BellSouth, give full consideration to competitive effects in both the interLATA and the local markets. Accordingly, for the reasons explained in Prof. Schwartz's supplemental affidavit, the Department's entry standard, far from delaying competition, promotes it, more than would dependence on post-interLATA entry enforcement to compel the BOCs to open their local markets.<sup>67</sup> In short, our view is that as soon as, but not before, the preconditions of the 1996 Act are met and a BOC is willing and able to provide -- at appropriate prices -- what competitors require for entry at various scales of operation, using interconnected separate facilities, unbundled elements, and resale, section 271 authority should be granted. Because BellSouth has not made this necessary showing, it would not be in the public interest to grant its section 271 application for Louisiana.

---

<sup>66</sup> DOJ South Carolina Evaluation at 48-50.

<sup>67</sup> Schwartz Supp. Aff. ¶¶ 36-59.

#### IV. Conclusion

BellSouth has not taken all measures needed to ensure that local markets in Louisiana are fully and irreversibly open to competition, both because it has not satisfied the requirements of the competitive checklist as discussed in part II of this Evaluation, and for the additional reasons discussed in part III of this Evaluation. Therefore, BellSouth's application for in-region interLATA entry in Louisiana under section 271 of the Telecommunications Act should be denied.

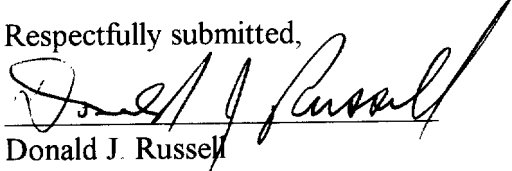
Joel I. Klein  
Assistant Attorney General  
Antitrust Division

Lawrence R. Fullerton  
Deputy Assistant Attorney General  
Antitrust Division

Thomas G. Krattenmaker  
Special Counsel for Policy and  
Regulatory Affairs  
Antitrust Division

Philip J. Weiser  
Senior Counsel  
Antitrust Division

Respectfully submitted,

  
Donald J. Russell  
Chief

Carl Willner  
Luin Fitch  
Frank G. Lamancusa  
Attorneys  
Telecommunications Task Force

W. Robert Majure  
Assistant Chief  
Economic Regulatory Section

Antitrust Division  
U.S. Department of Justice  
1401 H Street, N.W., Suite 8000  
Washington, DC 20530  
(202) 514-5621

December 10, 1997

## **APPENDIX A**

### **RESPONSE TO PROF. HAUSMAN'S CRITICISMS OF PROF. SCHWARTZ'S ANALYSIS FOR THE DEPARTMENT**

In its previous evaluations, as well as this one, the Department has relied on the Affidavit<sup>1</sup> and Supplemental Affidavit<sup>2</sup> of Prof. Marius Schwartz in support of its standard for evaluation and consideration of the public interest entry criterion of section 271 of the 1996 Act. The Supplemental Affidavit, and the Department's South Carolina Evaluation at 48-50 (attached to this Evaluation as Exhibit 5), address issues that other economic experts have raised regarding Prof. Schwartz's original analysis in his Affidavit, and explain why that analysis remains valid.

Only one of BellSouth's economic experts, Prof. Hausman, has attempted to respond to Prof. Schwartz's Supplemental Affidavit in any detail.<sup>3</sup> Most of his arguments have already been addressed by Prof. Schwartz and other experts, while others are simply unclear. For example, Prof. Hausman seems to think that Prof. Schwartz should change his position on the cost-benefit tradeoff of requiring local market opening before BOC interLATA entry in the wake of the Eighth

---

<sup>1</sup> Affidavit of Marius Schwartz, ("Schwartz Aff."), attached to this Evaluation as Ex. 1.

<sup>2</sup> Supplemental Affidavit of Marius Schwartz, ("Schwartz Supp. Aff."), attached to this Evaluation as Ex. 2.

<sup>3</sup> Reply Declaration of Prof. Jerry A. Hausman ("Hausman South Carolina Reply Decl."), attached to Reply Brief in Support of Application by BellSouth for Provision of In-Region, InterLATA Services in South Carolina, In re: Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina, CC Docket No. 97-208 (Nov. 14, 1997) ("BellSouth South Carolina Reply Brief") as App. Tab 2.



Circuit's recent decision on the Commission's local competition rules. But nothing in the Eighth Circuit's decision affects the validity of Prof. Schwartz's observation that prematurely granting BOC interLATA entry before the process of opening local markets is completed would likely encourage further delays that would "substantially impede the development of local competition." Schwartz Supp. Aff. ¶ 58. Not only would this create a clear harm to local consumers in the short term, but over the longer term, as Prof. Schwartz points out, "if local competition fails to develop exchange access alternatives, then BOC interLATA entry is likely, over time, to pose a growing threat to the ability of IXC's to compete, since IXC's' access needs will change over time and preventing discrimination in the establishment of new access arrangements is considerably harder than preventing the degradation of established arrangements." Schwartz Supp. Aff. ¶ 70 (citation omitted); see also id. ¶ 11.<sup>4</sup>

The more specific criticisms that Prof. Hausman directs at Prof. Schwartz's analysis are generally mistaken, and in a number of instances self-contradicting. For example:

- Prof. Hausman insists on the need to include consideration of elasticity of demand and changes in price, as well as market size, in the comparative market analysis,<sup>5</sup> yet

---

<sup>4</sup> Prof. Hausman continues to characterize inaccurately what Prof. Schwartz has said about competitive effects in long distance markets. Compare Schwartz Supp. Aff. ¶ 70 n.22, with Hausman South Carolina Reply Decl. ¶ 6 & n.3, and Declaration of Jerry A. Hausman ¶ 41 ("Hausman Louisiana Decl."), attached to Brief in Support of Application by BellSouth for Provision of In-Region InterLATA Services in Louisiana, CC Docket No. 67-231 (Nov. 6, 1997) ("BellSouth Louisiana Brief") as App. A, Vol. 1, Tab 5, which Prof. Hausman has not changed from his submission in South Carolina.

<sup>5</sup> Hausman South Carolina Reply Decl. ¶ 31.

nowhere in his own analysis does he consider such factors for any of the types of products and services included in the local markets served by the BOCs, apart from basic flat-rate residential local exchange service, the one type of local service that arguably is priced at or below cost.<sup>6</sup> Prof. Schwartz, in contrast, identified a number of BOC services, such as intraLATA toll, vertical services, ISDN and exchange access, that are over-priced and where competition is particularly likely to yield price benefits and increased output. And, as Prof. Schwartz has pointed out, competition will yield benefits in the provision even of currently subsidized services, as universal service subsidies are reformed on a competitively neutral basis and become available to all providers, not just incumbent LECs. Schwartz Supp. Aff. ¶ 23.<sup>7</sup>

- Both Prof. Schwartz and Prof. Hausman use the same long distance industry elasticity of demand of .7 in their evaluations of long distance markets.<sup>8</sup> Prof. Hausman

---

<sup>6</sup> Hausman Louisiana Decl. ¶¶ 24-25.

<sup>7</sup> The Consumer Federation of America, in its reply comments on BellSouth's interLATA entry application in South Carolina, has actually compared in quantitative terms the potential benefits of greater competition in local and long distance markets, building on the analysis by Prof. Schwartz. The CFA has estimated that while excess profits that might be returned to consumers from greater competition in long distance markets amount to \$0-2 billion annually, excess profits that could be returned to consumers from greater competition in all local markets amount to \$8-12 billion annually. Reply Comments of the Consumer Federation of America, In re: Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of InRegion, InterLATA Service in South Carolina, CC Docket No. 97-208 at Table 1 and App. A (Nov. 14, 1997).

<sup>8</sup> Hausman Louisiana Decl. ¶¶ 14, 20.

inappropriately criticizes Prof. Schwartz for doing so,<sup>9</sup> arguing he should have used firm elasticity instead. But Prof. Schwartz has correctly used the industry elasticity figure for the specific purposes indicated in his affidavit, which were (a) to compute the effect on the amount of access revenues associated with the industry-wide price change assumed by Prof. Hausman, and (b) to refute Prof. Hausman's suggestion that firms such as BOCs in the long-distance industry would have no incentive to raise the industry-wide price levels if they could. Schwartz Supp. Aff. ¶¶ 65, 68-70, 72-74.

- Prof. Hausman dismisses the potential price benefits from basic local exchange competition as "essentially zero" based on change in overall quantity of demand for a static product,<sup>10</sup> without considering the potential benefits consumers could realize from competition among firms, as well as other benefits from competition in the form of new products and improved service. He also simply assumes that because prices in local markets are regulated, there is nothing to be gained by introducing competition in them,<sup>11</sup> failing to address the well-recognized limitations of regulatory constraints compared with competitive ones that Prof. Schwartz identified, as well as the potential benefits of innovation. Schwartz Supp. Aff. ¶¶ 18-25 Prof. Hausman's views are at odds with the underlying premise of the Telecommunications Act that regulated monopoly is far inferior

---

<sup>9</sup> Hausman South Carolina Reply Decl. ¶ 36.

<sup>10</sup> Hausman Louisiana Decl. ¶ 25.

<sup>11</sup> Hausman South Carolina Reply Decl. ¶¶ 31-32; Hausman Louisiana Decl. ¶ 25.

to competition in ensuring that local telecommunications services are most efficiently provided to consumers. In fact, as indicated by Prof. Hausman's own analysis of long distance markets, a large share of the benefits to consumers from increased competition in telephone services reflects transfers to consumers derived from reductions in price, rather than simply increases in aggregate usage (though such increases would occur as well), and this can be expected to hold true for local services as well, so that Prof. Hausman's exclusive focus on industry elasticity of demand is inappropriate in evaluating costs and benefits in this context.

- Prof. Hausman continues to defend the "double marginalization" theory at the core of his analysis, while accusing Prof. Schwartz of misperceiving BOC incentives.<sup>12</sup> However, Prof. Schwartz was addressing BOC ability to reduce prices in the manner alleged, not incentives. As Prof. Schwartz points out, section 272(e)(3) of the 1996 Act requires that BOCs and their subsidiaries impute access charges, and "[t]his requirement would seem to restrict the BOCs' ability to behave in the manner stipulated by Professor Hausman and others." Schwartz Supp. Aff. ¶ 65. Prof. Hausman merely assumes that the statutory imputation requirements will be ineffective in affecting BOC behavior, yet he also assumes that BOC entry would be in compliance with the minimum requirements of the 1996 Act such as those in section 272.<sup>13</sup> At the same time, Prof. Hausman completely

---

<sup>12</sup> Hausman South Carolina Reply Decl. ¶ 34.

<sup>13</sup> Hausman South Carolina Reply Decl. ¶ 34; Hausman Louisiana Decl. ¶¶ 25, 42.

fails to respond to Prof. Schwartz's point that if the double marginalization concern were valid, it would apply with equal or greater force to benefits that could be realized from allowing long distance carriers to integrate vertically into local markets. Schwartz Supp. Aff. ¶¶ 66-67.

- In responding to Prof. Schwartz's key observation that an increase in BOCs' market share in long distance services could be achieved largely by diverting existing output and revenue away from IXC's rather than expanding industry output, Schwartz Supp. Aff. ¶ 74, Prof. Hausman mistakenly accuses Prof. Schwartz of trying to protect IXC's profits rather than consumer welfare.<sup>14</sup> He overlooks the very next sentence of Prof. Schwartz's analysis, in which Prof. Schwartz explained the relevance of his observation about diversion -- that, contrary to Prof. Hausman's claims, a BOC's substantial increase in long distance revenues "need not hinge on reducing industry price significantly; and hence a BOC may not have strong incentives to cut interLATA prices." Schwartz Supp. Aff. ¶ 74. This conclusion obviously goes directly to the issue of consumer welfare effects from BOC long distance entry.
- Though Prof. Hausman claims, in his long distance price analysis, to have averaged price differences over different customers' usage patterns,<sup>15</sup> it appears that he did so only by numbers of customers in each class, not by calling volume or revenues, which would

---

<sup>14</sup> Hausman South Carolina Reply Decl. ¶ 37.

<sup>15</sup> Hausman South Carolina Reply Decl. ¶¶ 38 n.26, 39.

greatly skew the results in light of the well-recognized large disparity between revenues and customer numbers.

- Prof. Hausman simply declares that BOCs will not have competitive advantages over IXCs in bundled services because competitors would also have the ability to bundle.<sup>16</sup> But the parity that Prof. Hausman casually assumes, in this and other respects, will not in fact exist until local markets have been fully and irreversibly opened to competition, e.g., through the establishment of nondiscriminatory wholesale support systems scaleable to meet competitive demand for resale and unbundled network elements, and procompetitive pricing of the local services and facilities that competitors must purchase from the BOC.

Prof. Hausman's attempted reliance on comparisons with telecommunications markets in the United Kingdom and Canada to support his claims is similarly unjustified:

- Competition in the United Kingdom. In complaining that Prof. Schwartz and others have not addressed evidence from the United Kingdom telecommunications markets about the development of local competition,<sup>17</sup> Prof. Hausman himself fails to present an accurate picture of developments in U.K. telecommunications markets and the special circumstances underlying them. Prof. Hausman's argument that full compliance with the requirements of section 271 is not needed because local competitors have attained a collective 7% local market share in the U.K. without unbundling of network

---

<sup>16</sup> Hausman South Carolina Reply Decl. ¶ 11.

<sup>17</sup> Hausman South Carolina Reply Decl. ¶ 35 n.22.

elements fails to appreciate several significant differences between the U.K. and the U.S. In the U.K., local competition was authorized nationwide over six years ago. The Telecommunications Act has been in effect in the U.S. only since February 1996, less than two years as of this filing, and there is no basis yet for evaluating the efficacy of the U.S. and U.K. approaches to local competition over a comparable time period of sufficient duration. The primary local competitors in the U.K. have been facilities-based cable companies that built out two-wire networks from the start for both cable and telephony services (unlike the one-wire U.S. cable systems constructed earlier), so that they did not have to incur additional expenses to rewire their networks for telephony (unlike U.S. cable companies).<sup>18</sup> Moreover, after six years of local competition, BT still retains substantial market power in local as well as domestic long distance services in the UK, as the Department has recently found.<sup>19</sup> The relevant point is not whether the U.K. has been able to achieve some degree of local competition relying exclusively on buildout of separate facilities -- an option primarily undertaken through the simultaneous initial installation of two wires by cable systems in the U.K, which is not possible for the already existing U.S. cable systems -- but rather whether the U.S. model, with its three entry

---

<sup>18</sup> Moreover, in the U.K. development of competition has been overseen by a single regulatory authority with comprehensive nationwide jurisdiction, in contrast with the U.S., where the resolution of fundamental issues of implementation, which is still underway, has taken place in the context of a far more complex federal system.

<sup>19</sup> United States v. MCI Communications Corp and BT Forty Eight Company, Civil Action No. 94-1317 (TFH), Memorandum of the United States in Support of Modification of the Final Judgment, at 5-6 (D.D.C. filed July 7, 1997).

paths, ultimately succeeds in bringing about a still more competitive local market. There is no basic disagreement in policy between the U.S. and the U.K. on the benefits of opening both local and long distance telephony markets, notwithstanding differences in the roads taken to reach that goal. In this regard, Prof. Hausman overlooks findings of the British regulator OFTEL concerning price trends in the U.K. before and after local competition began to develop,<sup>20</sup> which tends to bear out Prof. Schwartz's observation that competition in both local and long distance markets will better serve consumers than allowing vertical integration by a single carrier that retains a local monopoly. Schwartz Supp. Aff. ¶ 12. The U.K. authorities also reached the same conclusion in 1991, after several years of experience with a long distance duopoly and no local competition.<sup>21</sup>

- Competition in Canada. Prof. Hausman also cites as evidence of the benefits to be

---

<sup>20</sup> Substantial price decreases have occurred for many services in local markets in the U.K. between 1991 and 1996, after local competition began to emerge, and the weighted average of BT's local and long distance prices overall has been going down over the period since local competition began, whereas before such local competition existed in 1984-1991 and BT faced competition only in long distance markets, BT's weighted average of price changes as an integrated provider of services in local and long distance markets was increasing. OFTEL, Pricing of Telecommunications Services from 1997, Annexes to the Consultative Documents, Issued by the Director General of Telecommunications, Annex B, Trends in prices and quality of service, at 6, Table B2(a), attached to this Evaluation as Exhibit 8 (showing net cumulative increase in weighted average of BT local and long distance prices of +14.2% between 1984, when long distance competition began, and 1991, when the U.K. changed its duopoly policy and began authorizing local competition by cable providers, and net cumulative decrease in weighted average of BT local and long distance prices of -15.4% between 1991 and 1996).

<sup>21</sup> Department of Trade and Industry, Competition and Choice: Telecommunications Policy for the 1990s, at iii-iv (Mar. 1991) (concluding that the opening of all telecommunications markets in the U.K. to competition would lead to more choice of services, a wider range of services, and a more rapid decline in prices than would have otherwise occurred).



realized from vertical integration of BOCs into long distance certain prices available from vertically integrated long distance carriers in Canada,<sup>22</sup> but in fact the prices he relies on are no lower than the best prices already widely available in the United States from various non-integrated long distance providers that Prof. Schwartz has identified,<sup>23</sup> and are also similar to the average revenue received on a domestic U.S. long distance minute.<sup>24</sup>

---

<sup>22</sup> Hausman Louisiana Decl. ¶ 27; Hausman South Carolina Reply Decl. ¶ 35.

<sup>23</sup> Compare the long distance prices, in US dollar equivalents, that Prof. Hausman cites of 12.2 cents per minute for BC Tel in British Columbia, and 10-11.5 cents per minute for Telus in Alberta, Hausman Louisiana Decl. ¶ 27, to the rates that can already be obtained in the U.S. under various pricing plans of 12 cents per minute from MCI, 10 cents from AT&T and Sprint, and 9 cents per minute from LCI. Schwartz Supp. Aff. ¶ 85 n.38. Prof. Hausman's limited comparisons of a few Canadian carriers' rates with those of U.S. carriers under some pricing plans and periods cannot yield any supportable conclusions as to the relative overall competitiveness of U.S. and Canadian long distance markets.

<sup>24</sup> In 1996, average billed revenue per interstate direct dialed domestic minute in the U.S. was 11.57 cents, inclusive of access charges. Federal Communications Commission, Telecommunications Industry Revenue: TRS Fund Worksheet Data at Figure 5 (Nov. 1997).